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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-86576; File No. SR-LCH SA-2019-005]

Self-Regulatory Organizations; LCH SA; Notice of Filing of Proposed Rule Change Relating to Introduction of Clearing of the New Markit iTraxx Subordinated Financials Index CDS and the Related Single Name CDS Constituents and Enhancements to Wrong Way Risk Margin

August 6, 2019.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup> notice is hereby given that on August 2, 2019, Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II and III below, which Items have been prepared primarily by LCH SA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change**

Banque Centrale de Compensation, which conducts business under the name LCH SA (“LCH SA”), is proposing to amend its (i) Reference Guide : CDSClear Margin Framework and (ii) CDSClear Default Fund Methodology (together the “CDSClear Risk Methodology”) and (iii) CDS Clearing Supplement (“Supplement”) and (iv) CDS Clearing Procedures (“Procedures”) to incorporate new terms and to make conforming, clarifying and changes [sic] to allow clearing of the new Markit iTraxx Subordinated Financials Index CDS and the related single name CDS constituents.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

LCH SA is also amending its CDSClear Margin Framework to incorporate changes to the Wrong Way Risk margin in order to address some recommendations in respect of the risk model validation.

The text of the proposed rule change has been annexed as Exhibit 5.<sup>3</sup>

## **II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, LCHSA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. LCHSA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of these statements.

### **A. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change.**

#### **1. Purpose**

LCHSA is proposing to introduce clearing of the Markit iTraxx Subordinated Financials Index CDS and the related single name CDS constituents (“**SubFins**”) which is the natural next step following the recent changes in financial entities’ issuance patterns that are being rolled out in the wider industry.

In August 2016, IHSMarkit initiated the Markit iTraxx Europe rule review which prescribes how bank entities are included in the Markit iTraxx Europe Indices. At the time, the iTraxx Europe Index Advisory Committee identified that three differing regulatory approaches to TLAC/MREL regulations (Total Loss Absorbing Capacity /

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<sup>3</sup> All capitalized terms not defined herein have the same definition as the Rule Book, Supplement or Procedures, as applicable.

Minimum Requirements and Eligible Liabilities) eligible debt were driving new bank debt issuance patterns:

- Structural Subordination
  - Operating Company versus Holding Company (referred to as OpCoHoldCo)
- Contractual Subordination
  - Senior Non-Preferred Tier 3 Bonds, adopted by Danish, French and Spanish banks, (Seniority tier is SNRLAC: Senior Loss Absorbing Capacity)
- Statutory Subordination
  - All senior unsecured debt made eligible, adopted by German banks

Structural subordination was introduced in September 2017 and Contractual subordination in March 2018.

As a result of these different approaches, LCH SA now manages different levels of debt seniorities in its product scope and risk framework.

The proposed change will naturally extend the product scope eligible for clearing by completing the set of seniority with subordinated debt for financial entities.

For the purpose of introducing clearing of SubFins, LCH SA proposes to modify its CDS Clearing Supplement and Procedures to include the relevant language to allow the clearing of the SubFins.

LCH SA is also taking this opportunity to introduce a few changes to the Wrong Way Risk (“**WWR**”) margin in order to address some of the open model validation recommendations meant to improve the stability of the WWR margin and to include positions on the iTraxx Main index in the scope of products subject to the WWR margin.

Finally, a clarification to the Default Fund Additional Margin (“**DFAM**”), independent from the SubFins initiative, is also added to the CDSClear Default Fund

Methodology to reflect an adjustment requested by LCH SA's Risk Department for any clearing service in order to cap the DFAM to the Stress Test Loss Over Additional Margin ("STLOAM").

1) CDSClear Risk Methodology

The introduction of CDS with subordinated debt as an underlier is akin to introducing Senior Non Preferred debt, therefore the same margins need to be adapted, namely spread margin, wrong way risk, liquidity charge and jump-to-default risk margins (Short Charge and Self-Referencing Margin).

The Senior Non Preferred CDS differ from Subordinated financial CDS with respect to the availability of the historical market data and the recovery rate which for Subordinated debt is conventionally 20% (versus 40% for Senior debt).

The spread margin will use the historical data available for SubFins, and consider Subordinated and Senior debt as different financial instruments with regards to portfolio margining.<sup>4</sup>

Similarly, the WWR margin is extended to cover SubFins in addition to Senior CDS, as if they were different names from an offset perspective, and with shocks defined specifically for SubFins calibrated from the historical data available.

The Liquidity Charge will consider Markit iTraxx Subordinated Financials index to be a new hedging instrument, thus extending the existing framework. Then, similarly to the change introduced for Senior Non Preferred CDS, Senior and Subordinated financial CDS will be considered jointly from a concentration perspective. This leads to

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<sup>4</sup> See Article 27 of Commission Delegated Regulation (EU) No 153/2013)

the need to define a common concentration threshold, linearly interpolated between the thresholds that would be determined by our existing framework for each seniority.

The Short Charge margin is modified in two ways:

- (i) The recovery rates used in the calculation of exposures are shocked to capture any adverse move, hence increasing the exposure.
- (ii) The number of expected credit events in the 5 days following the default of a member has been decreased from 2 to 1, meaning we only retain the top exposure and no longer consider one of the riskiest entities.

Considering shocks in the recovery rates is necessary to ensure the difference between Senior and Subordinated CDS recovery rates is covered. Doing this without modifying the number of defaults would have led to overly conservative margins, with jump-to-default risk far outweighing the other risks. The second credit event has therefore been reclassified to being under the “extreme market conditions” category as opposed to the “normal market conditions” category.

In addition to moving from covering the default of two entities to one a floor to the short charge will be introduced. This floor is calculated as the 99.7% quantile of a loss distribution based on a single factor model. In other words, having calculated the exposure the portfolio has to each underlying reference entity, the probability of each combination of defaults is calculated (up to all entities in the portfolio defaulting at the same time) to define the maximum amount that could be lost with a 99.7% confidence due to default events. The greater of this calculated amount and the top exposure with a shifted recovery rate will be retained as being the Short Charge margin.

Consequently, the Stressed Short Charge has been revised with a similar calculation for exposures, with a recovery of 10% for senior debt and 0% for subordinated debt. The global short charge will now consider the top exposure plus the average of the riskiest entities (for an improved stability), while the financial short charge will consider the top two exposures on financial entities. For CDX.HY names specifically, the sum of the top two exposures and the average across the ten riskiest entities will be retained. The Stressed Short Charge would then be the max across those three components.

Separately, the model validation recommendations will lead to two changes to the WWR margin:

- (i) The calculation will be done as if the WWR margin was calculated inside the expected shortfall, leading to (a) the starting spread for the WWR P&L reflecting the spread level simulated in the scenarios selected as part of the spread margin and (b) the cap on the offset formula considering the maximum between the portfolio calculation and 20% of the sum of the instrument level calculations will now be applied to the sum of the spread margin and WWR margin (as opposed to the spread margin alone).
- (ii) The iTraxx Main index will now be included in the WWR margin calculation, with a dedicated shock defined, separately from the iTraxx Senior Financials and iTraxx Subordinated Financials indices.

Finally, the DFAM is updated and capped to the STLOAM to ensure that the sum of all resources called from a Clearing Member do not exceed the stress tested loss measured for that member. LCH SA's risk framework demands that the stress risk of a

given Clearing Member above and beyond a certain threshold (defined as a percentage of the size of the default fund and dependent on the internal credit score (ICS) of such member) be demutualised gradually through the DFAM.

On the other hand, as a CCP, LCH SA doesn't require its Clearing Members to deposit a total amount of resources for a given clearing service higher than their worst stress loss for that service. That is why the DFAM needs to be capped at the STLOAM as it is now defined in the CDSClear Default Fund Methodology.

## 2) CDS Clearing Supplement

The Supplement will be amended in order to include the relevant language to allow the clearing of the new Markit iTraxx Subordinated Financials Index CDS and related single name CDS.

In Part A of the Supplement, only Section 8.1. 'Creation of Matched Pairs' will be modified to correct inaccurate references to the CCM Client account structure in the current version of the Supplement. This change is not related to the SubFins initiative.

In Part B of the Supplement, the various references to 'Restructuring Credit Event' will be changed to 'M(M)R Restructuring' or new references to 'M(M)R Restructuring' will be created. Indeed, these provisions apply to transactions for which either 'Mod R' or 'Mod Mod R' is applicable. This change is required as clearing SubFins will introduce transactions for which Restructuring is an applicable Credit Event but where neither 'Mod R' nor 'Mod Mod R' are applicable. This is usually referred to as "Old R" (these terms are, for example, applicable to transactions under the Standard Subordinated European Insurance Corporate Transaction Type).

Such change will be reflected in Section 1.2. for the term ‘CEN Triggering Period’, ‘Compression Cut-off Date’, ‘DC Restructuring Announcement Date’, ‘DTCC Notice Facility’, ‘First Novation Date’, ‘NEMO Triggering Period’, ‘Novation Cut-off Date’, ‘Restructuring Matched Pair’, ‘Spin-off Single Name Cleared Transaction’, and also in Section 2.4 ‘Amendments to 2014 ISDA Credit Derivatives Definitions’, Section 4.1 ‘Determination of Credit Events and Successions Events’, Section 4.3 ‘Novation and Compression following Credit Events’, Section 4.4. ‘Re-couponing of Restructuring Cleared Transactions’, Section 5.1. ‘Creation and Notification of Restructuring Matched Pairs’, Section 5.2 ‘Creation of Restructuring Cleared Transactions’, Section 5.3 ‘Triggering of Restructuring Cleared Transaction’, Section 5.5 ‘Reversal of DC Credit Event Announcements’, Section 7.4 ‘Notification of DTCC Failure and Resolution’, Section 7.6 ‘Clearing Member Communications Failure Event, Section 8.1 ‘Creation of Matched Pairs’, Section 9.1 ‘Occurrence of Clearing Member Self Referencing Transaction’, Section 9.2 ‘Occurrence of Client Self Referencing Transactions’ and Sections 4.4 ‘Communications Failure Event’; 5 ‘Determination of Credit Events and Succession Events’ and 8.2 ‘Notification of Self Referencing Transactions’ of the ‘Appendix XIII: CCM Client Transaction requirements’.

There is also currently a number of provisions which are stated to apply to all Cleared Transactions which reference a Reference Entity. Clearing SubFins will introduce transactions which have the same underlying Reference Entity, but which have different seniorities (e.g. Senior Transactions and Subordinated Transactions) and in certain cases different Transactions Types. The treatment of transactions in case of credit event or succession event with respect to the relevant Reference Entity may vary



depending upon these terms, as it is possible for certain events only to apply to certain Transaction Types, or only to a certain seniority. Therefore, the current references to Reference Entity will no longer be sufficiently granular. As a result, we will add wording (predominantly in the relevant defined terms) which will enable a different treatment depending upon the Transaction Type and/or Reference Obligation. It is to be noted that the Reference Obligation is used to determine the seniority of a transaction.

Accordingly, in Section 1.2., the term ‘Affected Cleared Transaction’ will be amended in order to take into account the case where credit events or succession events apply to a Cleared Transaction (or, in the case of an Index Cleared Transaction, there [sic] relevant portion of such transaction defined as a Component Transaction) based on the Reference Entity but also on the applicable Transaction Type and/or Reference Obligation.

In addition, the term ‘Component Transaction’ will be created as it is currently mentioned in different Sections of the Supplement. The terms ‘Index Cleared Transaction’, ‘Index CCM Client Transaction’, and ‘Spin-off Single Name Cleared Transaction’ will be modified accordingly.

The terms ‘First Novation Date’, ‘Novation Cut-off Date’, and ‘Spin-off Single Name Cleared Transaction’ will be amended to provide for the correct treatment of transactions based on the combination of the Reference Entity, Transaction Type and Reference Obligation, and not only in respect of a Reference Entity.

Section 2.3. ‘Single Name Cleared Transaction Confirmation’ will be modified in order to take into account the fact that the form of confirmation for use with the Physical Settlement Matrix that incorporates the 2014 ISDA Credit Derivatives Definitions only

requires the election with respect to Restructuring to be included for the North American Corporate and the Standard North American Corporate Transaction Types, and that it be specified as “Not Applicable”. The proposed changes will simplify the wording and also enable the correct treatment of new Transaction Types introduced by the clearing of SubFins initiative.

Section 2.5. ‘Physical Settlement Matrix Updates’ will be modified to ensure the assessment of fungibility between terms of a Revised Matrix and an Existing Matrix is conducted for the relevant combination of Reference Entity, Transaction Type and Reference Obligation, and no longer only in respect of a Reference Entity.

In addition, for clarification/consistency purposes, in Section 1.2. the term “Relevant Physical Settlement Matrix” has been added, with a reference to Section 4.3 of the Procedures.

Furthermore, in line with the changes proposed under Part A of the Supplement, Section 8.1 ‘Creation of Matched Pairs’ will be modified to correct inaccurate references to the CCM Client account structure in the current version of the Supplement. This change is not related to the SubFins initiative.

In Part C of the Supplement, the term ‘M(M)R Restructuring Credit Event’ will be changed to ‘M(M)R Restructuring’ in order to align with the wording mentioned in Part B of the Supplement and with the 2014 ISDA Credit Derivatives Definitions.

Accordingly, in Section 1.2 the term ‘CEN Triggering Period’, ‘Compression Cut-off Date’, ‘DC Restructuring Announcement Date’, ‘First Novation Date’, ‘NEMO Triggering Period’, ‘Novation Cut-off Date’, ‘SRMP Triggerable Amount’ and Section ‘2.3 ‘Amendments to 2014 ISDA Credit Derivatives Definitions’, Section 4.1

‘Determination of Credit Events and Succession Events’, Section 4.2 ‘M(M)R Restructuring Credit Event Timeline’, Section 5.1 ‘Creation and Notification of Swaption Restructuring Matched Pairs’, Section 5.3 ‘Triggering of Swaption Restructuring Cleared Transactions’, Section 5.8 ‘Effect of Credit Event Notices and Notices to Exercise Movement Option’, Section 5.9 ‘Reversal of DC Credit Event Announcements’, Section 5.11 ‘Expiry of CEN Triggering Period’, Section 6.1 ‘Creation and Notification of Exercise Matched Pairs’, Section 7.1 ‘Creation of Index Cleared Transactions’, Section 7.2 ‘Creation of Initial Single Name Cleared Transactions for Settlement purposes in respect of Credit Events other than M(M)R Restructuring’, Section 7.3 ‘Creation of Restructuring Cleared Transactions for Triggering and/or Settlement purposes’, Section 7.4 ‘Creation of Initial Single Name Cleared Transactions in respect of untriggered M(M)R Restructuring Credit Events’, Appendix III ‘Form of Credit Event Notice’ and Section 8.2 ‘Creation of Restructuring Single Name Transaction’ of Appendix VIII ‘CCM Client Transaction Requirements’, will be modified.

Further, as mentioned *supra*, additional granularity is required to provide for appropriate treatment in case of a credit or succession event with respect to a Reference Entity, as such treatment will also be dependent upon the applicable Transaction Type and seniority. As a result, we will add wording (predominantly in the relevant defined terms) which will enable a different treatment depending upon the Transaction Type and/or seniority of a transaction. Accordingly, Section 4.2 ‘M(M)R Restructuring Credit Event Timeline’ will be modified in order to take into account the case where a M(M)R Restructuring is applicable to a combination of Reference Entity, Transaction Type and Reference Obligation, and not only in respect of a Reference Entity.

Furthermore, the term ‘Component Transaction’ will be created for consistency purposes, as it is currently mentioned in different Sections of the Supplement and will be created in Part B of the Supplement. The terms ‘First Novation Date’, ‘Novation Cut-off Date’ and Section 4.2 ‘M(M)R Restructuring Credit Event Timeline, Section 5.1 ‘Creation and Notification of Swaption Restructuring Matched Pairs’, Section 7.2 ‘Creation of Initial Single Name Cleared Transactions for Settlement purposes in respect of Credit Events other than M(M)R Restructuring’, Section 7.3 ‘Creation of Restructuring Cleared Transactions for Triggering and/or Settlement purposes’ and Section 7.4 ‘Creation of Initial Single Name Cleared Transactions in respect of untriggered M(M)R Restructuring Credit Events’ will be modified accordingly.

In addition, the cross-references mentioned in Section 1.2 ‘Swaption Clearing Member Notice’, ‘Swaption Clearing Member Notice Deadline’, Section 5.1 ‘Creation and Notification of Swaption Restructuring Matched Pairs’, Section 5.3 ‘Triggering of Swaption Restructuring Cleared Transactions’, Section 5.9 (e) ‘Reversal of DC Credit Event Announcements’, Section 6.1 ‘Creation and Notification of Exercise Matched Pairs’, Section 6.3 ‘Exercise and Abandonment by way of EEP’, Section 6.5 ‘EEP failure and resolution’, Section 6.7 ‘Termination of Exercise Cleared Transactions’, Section 6.8 ‘Consequences of no Swaption Clearing Member Notice or Swaption CCM Client Notice being received by LCH SA’, Section 8.1 ‘General Rules relating to Notices’, Section 8.2 ‘Failure to notify Matched Pairs’, Section 8.4 ‘Disputes as to Notices’, Section 9.1 ‘Creation of Matched Pairs’, Section 9.6 ‘Clearing Member matched with Itself’, Section 12 ‘Forms of Notices’ and Section 5.4 ‘Consequences of EEP Failure’ and 5.8 ‘Confidentiality Waiver’ of , Appendix VIII ‘CCM Client Transaction Requirements’

will be updated as they are not correct. These corrections are not related to the SubFins initiative but are due to an error in the cross references system.

Finally, in line with the proposed changes under Parts A and B of the Supplement, Section 9.1 ‘Creation of Matched Pairs’ will be modified to correct inaccurate references to the CCM Client account structure in the current version of the Supplement. This change is not related to the SubFins initiative.

The amendments to the CDS Clearing Supplement also contain typographical amendments and similar technical corrections.

### 3) CDS Clearing Procedures

LCH SA also proposes to modify Section 4 of the Procedures in order to take into account the changes to the CDS Clearing Supplement and therefore to enable different treatments depending upon the Transaction Type and/or seniority of a transaction.

In Procedure 4.3. ‘Eligible Reference Entities’, a reference to the Seniority Level of the Reference Obligation will be added, and the wording will also be modified in order to take into account a combination of Reference Entity, Transaction Type and Reference Obligation.

## 2. Statutory Basis.

LCH SA believes that the proposed rule change in connection with the clearing of SubFins is consistent with the requirements of Section 17A of the Securities Exchange Act of 1934<sup>5</sup> (the “Act”) and the regulations thereunder, including the standards under Rule 17Ad-22.<sup>6</sup> In particular, Section 17(A)(b)(3)(F)<sup>7</sup> of the Act

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<sup>5</sup> 15 U.S.C. 78q-1.

<sup>6</sup> 17 CFR 240.17Ad-22.

requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.

As noted above, the proposed rule change is designed:

- To manage the risk arising from the clearing of SubFins indices and single name CDS constituents, including collecting and maintaining financial resources intended to cover the risks to which LCH SA is exposed in connection with offering clearing services for SubFins. As such LCH SA will be able to minimize the risk that the losses associated with the default of a participant (or participants) in the clearing service will extend to other participants in the service.
- To streamline the description of the existing margin framework and default fund methodology for CDS to take into account SubFins and improve the organization and clarity of the CDSClear Margin Framework and Default Fund Methodology. The proposed changes to the Methodology guide provide additional clarity regarding LCH SA's risk methodology and enhance readability to further ensure that the documentation remains up-to-date, clear, and transparent. LCH SA believes that having policies and procedures that clearly and accurately document LCH SA's risk methodology and practices are an important component to the effectiveness of LCH SA's risk

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15 U.S.C. 78q-1(b)(3)(F).

management systems, which promotes the prompt and accurate clearance and settlement of securities transactions, derivatives agreements, contracts and transactions and contributes to the safeguarding of securities and funds associated with security-based swap transactions in LCH SA's custody or control, or for which LCH SA is responsible.

- To address the independent model validation recommendations on the WWR margin framework which LCH SA believes will enhance the WWR margin model by improving its ability to determine the total amount of margin that should be called and therefore collected to mitigate the spread risk on financial instruments, including on iTraxx Main indices for which circa 24% of the constituents reference Financial single names. This in turn would improve LCH SA's ability to manage financial risk exposures that may arise in the course of its ongoing clearance and settlement activities and thus better allow LCH SA to complete the clearance and settlement process in the event of a member default.

For these reasons, LCH SA believes that the proposed rule change should help promote the prompt and accurate clearance and settlement of securities transactions, derivatives agreements, contracts and transactions. Similarly, it should enhance LCH SA's ability to help assure the safeguarding of securities and funds which are in the custody or control of LCH SA or for which it is responsible.

LCH SA believes that the proposed changes to the CDSClear Margin Framework and the Default Fund Methodology satisfy the requirements of Rule 17Ad-22(e).<sup>8</sup>

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<sup>8</sup> 17 CFR 240.17Ad-22(e).

Rule 17Ad-22(b)(2) requires a clearing agency to use margin requirements to limit its credit exposures to participants under normal market conditions and to use risk-based models and parameters to set margin requirements.<sup>9</sup> Rule 17Ad-22(b)(3) requires each clearing agency acting as a central counterparty for security-based swaps to maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposure in extreme but plausible market conditions (the “cover two standard”). Rule 17Ad-22(e)(4) requires a covered clearing agency to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes by maintaining sufficient financial resources,<sup>10</sup> and Rule 17Ad-22(e)(6) requires a covered clearing agency that provides central counterparty services to cover its credit exposures to its participants by establishing a risk-based margin system that meets certain minimum requirements.<sup>11</sup>

As described above, LCH SA proposes to amend its CDSClear Methodology Framework to manage the risks associated with clearing SubFins. Specifically, the proposed rule change amends the Short Charge margin by shocking the recovery rates used in the calculation of the jump to default exposure as a function of the seniority of the underlying single name as well as by only considering the largest exposure and not the largest and the largest amongst the 3 riskiest anymore. It also amends the Liquidity Charge margin by setting the Markit iTraxx Subordinated Financial Index as an

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<sup>9</sup> 17 CFR 240.17Ad-22(b)(22).

<sup>10</sup> 17 CFR 240.17Ad-22(e)(4)(i).

<sup>11</sup> 17 CFR 240.17Ad-22(e)(6)(i).



additional hedging pillar as well as by commingling exposures on all seniorities of a given single name underlying reference to capture concentration risk appropriately. Finally, it updates all the other margin components of the total initial margin to incorporate SubFins. These changes are designed to use a risk-based model to set margin requirements and use such margin requirements to limit LCH SA's credit exposures to participants in clearing SubFins CDS and/or other CDS and CDS Options under normal market conditions, consistent with Rule 17Ad-22(b)(2). LCH SA also believes that its risk-based margin methodology takes into account, and generates margin levels commensurate with, the risks and particular attributes of each of the SubFins and other CDS as well as CDS Options at the product and portfolio levels, appropriate to the relevant market it serves, consistent with Rule 17Ad-22(e)(6)(i) and (v). In addition, LCH SA believes that the margin calculation under the revised CDSClear Margin Framework would sufficiently account for the 5-day liquidation period for house account portfolio and 7-day liquidation period for client portfolio and therefore, is reasonably designed to cover LCH SA's potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default, consistent with Rule 17Ad-22(e)(6)(iii). LCH SA also believes that the current pricing methodology with respect to CDS, based on widely accepted ISDA Model with appropriate adjustments for SubFins, as supplemented by methodology for circumstances in which pricing data are not readily available, would generate reliable data set to enable LCH SA to calculate spread margin, consistent with Rule 17Ad-22(e)(6)(iv).

Further, Rule 17Ad-22(b)(3) requires a clearing agency acting as a central counterparty for security-based swaps to establish policies and procedures reasonably designed to maintain the cover two standard.<sup>12</sup> Similarly, Rule 17Ad-22(e)(4)(ii) requires a covered clearing agency that provides central counterparty services for security-based swaps to maintain financial resources additional to margin to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, meeting the cover two standard.<sup>13</sup> LCH SA believes that its Default Fund Methodology, with the modifications described herein, will appropriately incorporate the risk of clearing SubFins CDS, which, together with the proposed changes to the CDSClear Margin Framework, will be reasonably designed to ensure that LCH SA maintains sufficient financial resources to meet the cover two standard, in accordance with Rule 17Ad-22(b)(3) and (e)(4)(ii).<sup>14</sup>

LCH SA also believes that the proposed rule changes are consistent with the requirements of Rule 17Ad-22.<sup>15</sup> Rule 17Ad-22(e)(17) requires a covered clearing agency to manage operational risks by (i) identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls; (ii) ensuring that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable

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<sup>12</sup> 17 CFR 240.17Ad-22(b)(3).

<sup>13</sup> 17 CFR 240.17Ad-22(e)(4)(ii).

<sup>14</sup> 17 CFR 240.17Ad-22(b)(3) and (e)(4)(ii).

<sup>15</sup> 17 CFR 240.17Ad-22.

capacity; and (iii) establishing and maintaining a business continuity plan that addresses events posing a significant risk of disrupting operations.<sup>16</sup>

As described above, the proposed rule change will enable LCH SA to extend its CDSClear product offering to SubFins as CDSClear has been clearing Senior Financials Indices and Single Names since June 2015. The process and controls already in place to manage Senior Financials will apply to SubFins and no additional operational risk is created in relation to SubFins.

In accordance with the model validation recommendations, the proposed changes on WWR would also improve the stability and accuracy of the WWR margin so that LCH SA can better determine the full margin amount to be collected by the CCP that LCH SA believes is consistent with the relevant requirements of Rule 17Ad-22.<sup>17</sup> Rule 17Ad-22(e)(6)(i)<sup>18</sup> requires LCH SA to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in a margin system that, at a minimum, considers and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.

Rule 17Ad-22(e)(2)<sup>19</sup> requires LCH SA to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Act.<sup>20</sup>

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<sup>16</sup> 17 CFR 240.17Ad-22(e)(17).

<sup>17</sup> 17 CFR 240. 17Ad-22

<sup>18</sup> 17 CFR 240. 17Ad-22(e)(6)

<sup>19</sup> 17 CFR 240. 17Ad-22(e)(2)

<sup>20</sup> 15 U.S.C. 78q-1.

LCH SA's governance arrangements clearly assign and document responsibility for risk decisions and require consultation with or approval from the LCH SA Board, Risk committees, or management. CDSClear's proposed rule changes were decided in accordance with the LCH SA governance process, which included review of the changes to the CDSClear Margin Framework and related risk management considerations by the LCH SA Risk Committee and approval by the Board. These governance arrangements continue to be clear and transparent, such that information relating to the assignment of responsibilities for risk decisions and the requisite involvement of the LCH SA Board, committees, and management is clearly documented, consistent with the requirements of Rule 17Ad-22(e)(2).<sup>21</sup>

For the reasons stated above, LCH SA believes that the proposed rule change with respect to the CDSClear Margin Framework, the CDSClear Default Fund Methodology, as well as the Supplement and Procedures in connection with the clearing of SubFins are consistent with the requirements of prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts and transactions, and assuring the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible, in accordance with Section 17(A)(b)(3)(F)<sup>22</sup> of the Act, with the requirements of operational risk management in

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<sup>21</sup> 17 CFR 240. 17Ad-22(e)(2)

<sup>22</sup> 15 U.S.C. 78q-1(b)(3)(F).

Rule 17Ad-22(e)(17)<sup>23</sup>, and with clear and transparent governance arrangements in Rule 17Ad-22(e)(2)<sup>24</sup>.

B. Clearing Agency's Statement on Burden on Competition.

Section 17A(b)(3)(I) of the Act requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.<sup>25</sup> LCH SA does not believe that the proposed rule change would impose burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Act. Specifically, the proposed changes to the CDSClear Margin Framework, Default Fund Methodology, Supplement and Procedures would apply equally to all Clearing Members whose portfolios includes SubFins and other CDS and CDS Options. Because the margin methodology and default fund sizing methodology are risk-based, consistent with the requirements in Rule 17Ad-22(b)(2) and (e)(6), depending on a Clearing Member's portfolio, each Clearing Member would be subject to a margin requirement and default fund contribution commensurate with the risk particular to its portfolio. Such margin requirement and default fund contribution impose burdens on a Clearing Member but such burdens would be necessary and appropriate to manage LCH SA's credit exposures to its CDSClear participants and to maintain sufficient financial resources to withstand a default of two participant families to which LCH SA has the largest exposures in extreme but plausible market conditions, consistent with the requirements under the Act as described above.

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<sup>23</sup> 17 CFR 240.17Ad-22(e)(17).

<sup>24</sup> 17 CFR 240.17Ad-22(e)(2).

<sup>25</sup> 15 U.S.C. 78q-1(b)(3)(I).

Therefore, LCH SA does not believe that the proposed rule change would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

C. Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. LCH SA will notify the Commission of any written comments received by LCH SA.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form

(<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-LCH SA-2019-005 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, N.E. Washington, D.C. 20549-1090.

All submissions should refer to File Number SR-LCH SA-2019-005. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, N.E., Washington, D.C. 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of LCH SA and on LCH SA's website at: <https://www.lch.com/resources/rules-and-regulations/proposed-rule-changes-0>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-LCH SA-2019-005 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>26</sup>

Jill M. Peterson,  
Assistant Secretary.

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<sup>26</sup> 17 CFR 200.30-3(a)(12).



